

The Virginia State Banker

Regulatory news for Virginia State-chartered Banks

E.J. Face, Jr., Commissioner

Bureau of Financial Institutions - State Corporation Commission

HANDS ACROSS THE SEA - AZERBAIJAN TO STANLEY, VIRGINIA

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The Bureau of Financial Institutions (Bureau), in cooperation with USAID and Bankworld, recently hosted two representatives from the bank supervision department of the National Bank of Azerbaijan (NBA). Rashad Orujov, Chief Economist/Bank Supervision, and Azer Aliyev, Department of Supervision and Licensing, were in the United States to learn about the U.S. banking system to help with the transition from the Soviet system to an effective, international standards system.

The Republic of Azerbaijan is on the Caspian Sea. Immediate neighbors

are the Russian Federation on the north, Iran on the south, and Turkey on the southwest -- with Armenia and Georgia on the west. Following an initial recovery after the collapse of the economic regime established in the former Soviet Union, the Azerbaijani economy is now poised to meet the challenges of the transition to a market economy. The NBA, created in February 1992, is the bank regulatory agency and central bank of Azerbaijan, a role similar to that of the Federal Reserve System in the United States.

Rashad Orujov and Azer Aliyev joined bank examiners

from the Bank and Thrift Supervision Section of the Bureau during a regularly scheduled safety and soundness examination of Pioneer Bank in Stanley, Virginia. They were particularly interested in obtaining hands-on experience of the regulatory process and an understanding of how a strong and diverse economy contributes to a sound banking system.

Robin Hall, Senior Financial Analyst and Examiner in Charge, led the Bureau's team of financial analysts for the examination.

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The Virginia State Banker is published by the Virginia Bureau of Financial Institutions to provide useful information to the banks and savings institutions that it regulates, and any of their related interests. Reader comments and suggestions are welcome and should be addressed to Ginger Sandler, Bureau of Financial Institutions, P.O. Box 640, Richmond, Virginia 23218-0640, or via e-mail gsandler@scc.state.va.us.

ACKNOWLEDGMENTS

Thanks to the following persons for their help in producing this issue of *The Virginia State Banker*: Commissioner Face, John Crockett, Charles Dickerson, Robin Hall, Betty Hicks, Jon Orne, Jane Owen, Mark Pinson, and Todd Rose.



Pictured from left to right are Pioneer Bank President Thomas Rosazza, Principal Financial Analyst Bob Bishop, National Bank of Azerbaijan representatives Rashad Orujov and Azer Aliyev, Senior Financial Analyst Mark Trenor, Principal Financial Analyst John Turner, Senior Financial Analyst Fred Doyle, and (front) Examiner in Charge Robin Hall.

BANK SECRECY ACT/ANTI-MONEY LAUNDERING EXAMINATIONS

In late September, the following letter was sent to the chief executive officer of each Virginia-chartered bank explaining our decision to begin performing Bank Secrecy Act/Anti-money Laundering examinations.

As you are aware, federal agencies have an increased focus on compliance in the areas of bank secrecy and anti-money laundering activities. Recently, it was announced that in those jurisdictions where state authorities do not con-

duct Bank Secrecy Act and Anti-money Laundering (BSA/AML) examinations, federal agency personnel will accompany State examiners on their regular examinations in order to conduct these examination activities, or will make an additional entry into the institution at another time.

In order to avoid this additional regulatory intrusion, Bureau examining personnel have received, and will con-

tinue to receive, training in these areas of increased focus, and will now be conducting BSA/AML reviews as a part of routine examination activities.

On-site training is an integral part of our education program, and we appreciate your understanding as we move forward with this initiative.

If you have any questions about this matter, please call John Crockett at (804) 371-9704.



Recently, representatives of the Bureau met with Mr. Xianping Xu, Vice Governor of The People's Government of Hunan Province, China, to discuss financial institution regulation/supervision, and the history and growth of the credit system in Virginia and the U.S. Pictured from left to right are Deputy Commissioner Nick Kyrus, Mr. Xianping Xu, Commissioner Joe Face, and Senior Financial Analyst Locke Trigg.

VIRGINIA BANK DIRECTORS' COLLEGE

Forty-five Directors from Virginia's community banks attended the Virginia Bank Directors' College, *Essential Principles* session, at the Boar's Head Inn, Charlottesville, on November 3-4, 2004.

David Baris with the American Association of Bank Directors, outlined and discussed the changing role and responsibilities of Bank Directors. Representatives from the Bureau and the Federal Reserve Bank of Richmond discussed corporate governance,

CAMELS, and responding to examination findings.

Developed in conjunction with State and federal regulators, the Virginia Bank Directors' College provides Bank Directors an opportunity to become more effective, capable, and supportive members of a bank's board of directors.

The *Emerging Issues* session will be held April 6-7, 2005 at The Jefferson Hotel in Richmond. This session highlights information applicable to all Bank

Directors and provides an opportunity for Bank Directors to remain informed and current on industry/bank-specific issues.

Registration and meeting activities are coordinated through the Virginia Association of Community Banks, (804) 673-8250. The program brochure will be mailed late February 2005. Space is limited, so please register early.

HANDS ACROSS THE SEA (continued from page 1)

Team members included Principal Financial Analysts Bob Bishop, John Campbell, Dan Hearn, and John Turner; Business Systems Analyst Cindy Cannaday; and Senior Financial Analysts Fred Doyle, Ron Prillaman, Ray Sutphin, Mark Trenor, and Wayne Woods.

During the examination of Pioneer Bank, Bureau examiners provided explanations and reference material to our guests on the following topics: quarterly reporting of commercial banks in the U.S. and the development of a Uniform Bank Performance Report, the various types of examinations used by the U.S. bank regulatory agencies, the system of examination and administration for both off-site and on-site examinations, an understanding of the type of relationship examiners have with the banker and bank being examined, and the process for issuing charters. In addition, Bureau team members provided our guests with a thorough review of the process for rating Sensitivity to Market Risk. Reportedly, the NBA provides no separate review and rating for Sensitivity to Market Risk.

Messrs. Aliyev and Orujov attended the exit meeting with Pioneer Bank's full Board of Directors. We extend our sincere appreciation to Pioneer Bank President and Chief Executive Officer Thomas Rosazza, the Board of Directors, and the staff of Pioneer Bank for welcoming our guests and cooperating with this international exchange of information.

Ms. Hall noted, "I hope we demonstrated that by fostering a relationship with our bankers of mutual respect and commonality of goals, we promote a stronger state banking system and add value to our state charter. If we were as effective as I believe we were with this lesson, I would deem this experiment a complete success."

Our guests also had a session on payments system risk with representatives of the Federal Reserve Bank of Richmond and a session on economic development by representatives of the Virginia Economic Development Partnership.

BUREAU EMPLOYEES RECEIVE SERVICE PINS

The State Corporation Commission (SCC) recognizes employee service by presenting pins for every five years of service. At a recent ceremony, employees with 20 or more years of service received pins presented by the three Commissioners. Bureau employees receiving pins this year for years of service are as follows.

30 years: Steve Pemberton

25 years: Joe Face, Gerald Fallen, Jeanette Sanders

20 years: Fred Doyle, Ginger Sandler, Edith Starsja, Dwight Stephens, Carl Williams

15 years: Harry Klanian, Locke Trigg

10 years: Steve Brannan, Cindy Cannaday, Janice Charity, Kathy Hearn, Selina Johnson, Werner Paul, Ron Prillaman

5 years: Betty Hicks, Antonio Muniz-Perez, Bill Opperman, Jim Sherwood, Ray Sutphin

Congratulations to all!



SCC E-MAIL AND WEB SITE ADDRESS CHANGES

In January 2005, the SCC Internet address will change from **state.va.us/scc** to **scc.virginia.gov**, and the Bureau page will be located at **<http://scc.virginia.gov/division/banking/index.htm>**. All SCC E-mail addresses will change to **firstname.lastname@scc.virginia.gov** (ex:

jane.doe@scc.virginia.gov). The address formats conform to the standard being used by all state governments throughout the U.S. The old Web and E-mail addresses will work for an as yet undetermined amount of time.

REVISITING THE LEGAL LENDING LIMIT

§ 6.1-61 OF THE CODE OF VIRGINIA

In the Spring 1998 edition of this newsletter, we published an article on the legal lending limit, FASB Statement No. 115 (FASB 115), and when to aggregate loans to an individual with loans guaranteed or endorsed by the individual for legal lending limit purposes. Significant water has passed under the bridge since that article, and we wanted to review the current law and Bureau interpretations. This article will focus on the general case, and subsequent articles will address partnerships, limited liability companies, and special collateral exceptions.

The only change to the statute itself was in 2002 when the loan loss reserve was added to the legal lending limit calculation. This was done to provide parity with national banks. Therefore, the basic lending limit calculation looks like this:

[All paid-in preferred and common stock + all related surplus + undivided profits (retained earnings) as of the date of the most recent call report (line 26a) + all general loan loss reserves as of the date of the most recent call report (specific reserves are excluded) + capital notes and debentures that have been approved IN WRITING by the SCC] x .15 = the limit of loans to one borrower

Some of the intricacies of this formula result from the definitions of certain terms, and practical application. We typically follow generally accepted accounting principles and definitions, with an occasional adjustment for call report instructions or practical need.

“Capital” includes all paid-in preferred or common stock at par value. “Surplus” includes those additional amounts related to stock in excess of par value. “Loan loss reserve” is as reported on the most recent call report unless specific reserves are included (in which case they would need to be subtracted). “Undivided profits” (retained earnings) is as defined in the call report. “Capital notes and debentures” (consisting of subordinated debt) can be included in the lending limit calculation if the bank has the written approval of the SCC.

The decision to not include the FASB 115 adjustment was made to preclude significant legal lending limit changes due to movements in interest rates and market prices. The statute actually ties undivided profits (retained earnings) to the most recent call report date, so it was logical to tie the loan loss reserve to the same date.

Figuring 15% of capital may be easy work, but exceptions to the rule and determining when to aggregate or connect

borrowers can be a real job. The basic premise of the legal lending limit is to require diversification of assets. The Code of Virginia is structured to address the issue on a per-borrower or -obligor basis. As we are all aware, not all borrowers are independent of one another. Since that is the case, the Bureau holds an institution to a standard of both legal compliance and good lending practice. Loans are not necessarily good just because they are legal. For instance, a husband and wife with one income have two legal lending limits. Legally, a bank can lend to its limit to each spouse, but should it? Take an individual and his 100%-owned corporation. Legally, loans to the legal limit can be made to both. It may or may not be good lending practice. And then to complicate matters, what about endorsements and guarantees? Would they not surely tie borrowers together? The answer once again is a “definite maybe.”

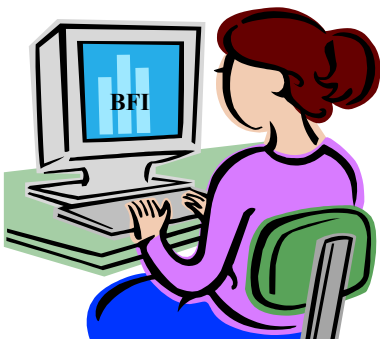
Bureau positions have been formulated in an effort to accommodate good underwriting practice. We believe it is good to obtain endorsements and guarantees when possible; however, when they are taken as an “abundance of caution” and not for underwriting purposes, we do not believe the transaction is subject to the legal lending limit for the endorser or guarantor. Applying this interpretation requires good documentation. The loan file should clearly indicate and support a history of primary and secondary sources of repayment for the loan. Adequate cash flow and collateral are examples and would relegate any additional security provided by endorsements and guarantees to being an abundance of caution. Having documentation precludes any subsequent decline in financial condition of the borrower from bringing the legal lending limit into question. There can be no subsequent violation by loans that are legal when made; therefore, adequate documentation at origination is important. After any decline in financial condition, a reassessment regarding combining loans for lending limit purposes would be necessary. However, if new money is advanced as part of a workout, it likely would create a violation because the endorsement or guarantor would no longer be taken as “an abundance of caution.”

Whenever you have legal lending limit questions (maybe even because of or in spite of this article), please feel free to contact the Bureau. Questions can be directed to Principal Analysts Charles Dickerson and Jay Russell or to Deputy Commissioner John Crockett. We prefer a written request (or fax) so we can be sure we have considered all relevant data, but are always willing to discuss issues with you.

IMPORTANT TELEPHONE NUMBERS

- Banks and Savings Institutions (804) 371-9704
- Consumer Finance and Mortgage Companies (804) 371-9701
- Licensing (applications, name changes, annual reports) (804) 371-9690
- Consumer Complaints (804) 371-9705
- Corporate Information (SCC Clerk's Office) (804) 371-9733
- Bureau's FAX number (804) 371-9416
- TDD (804) 371-9206

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Check out our Web site at
[www.state.va.us/scc/division/
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